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Summary of the economic survey of Latin America and the Caribbean, 1998

Executive summary

The Latin American and Caribbean region will remember 1998 as one of the most problematic years of recent times. The severe effects of the international financial crisis that broke out in Asia in mid-1997 restricted the region's access to external financing. Tumbling export prices translated into the first drop in the value of the countries' exports to be recorded so far this decade, and this in turn led to a further deterioration in the balance-of-payments current account. Faced with this bleak outlook on the external front, economic authorities displayed a strong determination to confront the crisis head on and build confidence by applying no-nonsense monetary, fiscal and exchange-rate policies.

The year's events also included adverse weather conditions on a perhaps unrivalled scale. First there was El Niño, which affected the entire region. Then came a series of hurricanes that ravaged a number of Central American and Caribbean countries. Despite these upheavals, the economies of Latin America and the Caribbean did fairly well, especially considering the fact that macroeconomic policy was primarily focused on achieving and maintaining stability. Nonetheless, the average growth rate for the region was halved, falling from 5.5 to 2.2 per cent, and the prospects for 1999 are sombre. Unemployment rose, although moderately, while the region's average inflation rate levelled off at slightly over 10 per cent. Prudent policy management enabled the region to avoid, at least during the year, the turbulent sorts of exchange-rate adjustments experienced by some of the emerging Asian economies in 1997 and by the Russian Federation in 1998. But the turbulence witnessed during the first months of 1999 demonstrates that all the virtues of the decade's structural reforms and macroeconomic policy measures notwithstanding, the region needs to make further progress in reducing its external vulnerability.

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I. Introduction

1. In 1998, the Latin American and Caribbean countries had to deal with an extremely high degree of volatility in international finance and trade. Considering the strength of the negative external shocks that dampened growth and seriously hampered the management of fiscal and external accounts, the region's economies performed reasonably well, at least up to the fourth quarter. This volatility is still in evidence, however, and many of these shocks have a delayed effect. Consequently, the outlook for 1999 remains highly problematic.

2. The average growth rate was down sharply, from 5.5 per cent in 1997 to 2.2 per cent in 1998, but even so was higher than the average for the world economy as a whole (1.7 per cent). These figures are annual averages, however, and therefore do not reflect the intensification of economic problems that occurred as the year drew on. The typical pattern in most cases was high growth rates during the first six months, owing to the momentum of the 1997 economic expansion, but very slow growth or even contractions during the last two quarters. Employment figures followed a similar trajectory, with the regional unemployment rate holding fairly steady during the first half of the year but climbing during the second. The strongest aspect of the region's performance was in the area of inflation, which has levelled off at about 10 per cent during the past two years, the lowest rate since 1949. The current account deficit widened substantially, jumping from US$ 64 billion in 1997 to US$ 83 billion in 1998, at the same time that capital inflows dropped from US$ 80 billion to US$ 62 billion. Thanks to the region's high level of international reserves, however, it was able to cover its overall US$ 21 billion balance-of-payments deficit, most of which was accounted for by Brazil. It is important to note, however, that the decrease was due to reductions in short-term capital and that long-term capital inflows were nearly as high as their 1997 record level.

3. Interestingly, the types of problems that were experienced in 1998 and their implications differed significantly across subregions. For reasons that varied from one country to the next, South America was especially hard hit. In most cases, these countries' export prices were sharply lower, and in Chile and Peru the effects of this downswing were compounded by the loss of Asian markets. Another factor within the financial market was that a number of these countries (especially Brazil and Argentina) have well-developed stock markets that provide a vulnerable flank for international volatility. In addition, the spillover from the troubled Brazilian economy has been especially forceful in the Southern Cone.

4. In contrast, Mexico and most of Central America were able to take advantage of the booming United States economy to increase the volume of their exports to that country. Furthermore, in a departure from the trend for the region as a whole, which registered a deterioration in its imports/exports price ratio, the terms of trade of most of the Central American nations were better than they had been in 1997. Although various Central American and Caribbean countries sustained severe damage as a result of the hurricanes that ravaged the subregion in the closing months of the year, the brunt of these storms' economic impact will not be felt until later. Mexico was also hurt by the year's financial shocks, but thanks to its geographic location in the northern hemisphere, its economy turned in a somewhat better growth performance than the South American countries did. Many Caribbean economies registered another mediocre year, as average growth for this subregion was just over 1 per cent.

5. The first quarter of 1999 was overshadowed by the worsening regional situation, when the devaluation of the Brazilian real in January sent shock waves to all the Latin American currency markets. This all demonstrates that even though the region weathered the international crisis fairly well during 1998, the depth of the problems facing Latin America and the Caribbean should not be underestimated. The region's external vulnerability, about which the Economic Commission for Latin America and the Caribbean (ECLAC) has expressed increasing concern in recent years, continues to manifest itself in both the trade and financial spheres. Export prices remain very low, and the possibility that reserves may fail to rebound cannot be ruled out. The cost of financing countries' growing current account deficits is very high since the spreads over industrialized countries' interest rates for bond issues have widened by several points, while stock quotations have tumbled.

6. At the same time, Governments face difficult decisions in connection with their macroeconomic goals. They must choose between raising interest rates in order to protect their exchange rates and guard against any setbacks in terms of inflation, thus slowing the growth of output and employment, or devaluing the currency in order to maintain international competitiveness, which heightens the risk of inflation and adds to the external debt-service burden, and may also drive down real wages. In practice, so far the majority of the Governments have chosen to follow the first option, at least as long as exchange markets can be convinced of the sustainability of this strategy.

7. Projections for 1999 suggest that the difficulties of the second semester of 1998 are likely to continue, at least into the first half of the new year. Austerity measures to deal with

deficits on the fiscal and/or external accounts will leave little room for expansion, although those Governments that opt for large devaluations — with all the risks that they imply — may be able to stimulate their economies through increased exports. Overall, ECLAC estimates suggest that growth for the year will be negative, while inflation should remain in single digits in the majority of the countries.

II. Macroeconomic policy

8. The general orientation of macroeconomic policy in 1998 was towards renewed austerity. There were at least two reasons for this. First, there were the effects of the Asian crisis and its intensification in the second half of the year after the Russian Federation devalued the rouble and declared a partial moratorium on its foreign debt. Faced with investors' newly aroused doubts about risk in emerging markets, the Latin American Governments (with only a few exceptions) decided to send out a clear signal that their priority was to be exchange-rate stability and, hence, austerity.

9. Another related factor was the widening of external disequilibria; this process had been under way for several years but worsened substantially for some countries as a result of the negative terms-of-trade shock of 1998. Markets were also less willing to finance these deficits, and the small amount of credit that was available became increasingly expensive, with no signs of a quick return to the falling rates and abundant credit that had characterized most of 1997.

10. Thus, there have been two turning points in recent macroeconomic policy. The first was the sharp change in course made in October 1997 when the Asian crisis began to have its first serious ramifications in Latin America and Governments began to adopt more cautious monetary and fiscal policies. The second turning point was marked by the intensification and reinforcement of this new line of economic policy as the international financial crisis deepened in August and September 1998.

Fiscal deficits widen

11. Despite more cautious policies, the average (unweighted) fiscal deficit for the region increased by one percentage point to 2.4 per cent of gross domestic product (GDP) in 1998. Although this is still quite low when compared to the figures for the 1980s, it is the highest to be recorded so far this decade. The main cause of this increase was a decline in current income due to slower growth. The fairly generalized reduction in tax revenues was accentuated by the slump in commodity prices, especially in the case of the petroleum-exporting countries (Ecuador, Mexico, Trinidad and Tobago, Venezuela) and metal exporters (Chile, Jamaica). At the same time, expenditure was trending upward owing to higher interest rates (Brazil), increased social budgets and higher public-sector wages, the extraordinary expenditures made necessary by natural disasters (El Niño in Peru and Ecuador, hurricanes in the Caribbean and Central America) and social security reforms (Bolivia, Uruguay).

12. In response to this situation, which had already become evident by the end of 1997, several countries (Argentina, Brazil, Colombia, El Salvador and Venezuela) raised taxes and bolstered their tax collection efforts. As part of a more widespread response, many Governments in the region also began to make adjustments on the expenditure side, chiefly through reductions in spending on infrastructure and other investment outlays. Public-sector employment and current government consumption were also cut in some cases, but the general tendency was to protect social-sector expenditure. Nevertheless, these efforts proved insufficient to hold down costs and compensate for lower revenue, and in most cases fiscal policy thus failed to play a useful role in cooling domestic demand or in controlling countries' rising external deficits.

Monetary policy tightened substantially

13. Under these circumstances, most of the burden of adjustment has fallen on monetary policy. The expansion of the money supply and credit facilitated economic growth during 1996 and most of 1997, accommodating the increased demand for local currencies generated by the reconstitution of real monetary balances once their purchasing power had been restored. In October 1997, there was an abrupt change in this trend. After reaching a peak of about 18 per cent in real terms, the average monetary growth rate began to slow and has been falling steadily ever since. It was almost zero in June and July 1998, and thereafter turned negative. In several countries, the drop in the real money supply reached two digits.

14. This trend in the real money supply during 1998 was attributable to the decrease in foreign assets experienced by most countries in the region. This was not offset by easier domestic credit terms since interest-rate policy has been used to attract foreign capital and protect the value of the currency when it has come under attack. The higher cost of credit has also been instrumental in reducing the expansion of domestic demand and keeping it in line with the slower pace of economic growth.

15. Real deposit rates, whose across-the-board average was slightly negative at the beginning of 1998 due to seasonal inflationary factors, started to climb in April. Decreasing rates of inflation compounded the rise in nominal interest rates in the second semester, and the region's average deposit rate at year's end stood at 10 per cent. In some countries, such as Brazil, real interest rates were much higher. Interest rate hikes for lending were consistently higher than the increases in rates on deposits, so spreads widened.

16. Overall, monetary policy was successful in cooling down the region's economies (the growth of domestic demand turned out to be negative for the fourth quarter of 1998 in many countries of the region) and preserving the value of their local currencies. As a consequence of a number of Governments' decision to rely entirely on monetary instruments in their quest for equilibrium, however, financial costs have reached new highs that may jeopardize future growth prospects. In countries with weak financial sectors, the surge in real interest rates, coupled with slower economic growth, translated into an increase in non-performing loans and a further deterioration of bank assets. Some countries were again hit by banking crises (Ecuador, Paraguay), while others faced greater than expected difficulties in sorting out the consequences of past ones (Jamaica, Mexico).

Exchange-rate policy increasingly controversial

17. With the tightening of international and domestic credit markets and the resulting slowdown in most economies of the region, the issue of exchange-rate policy became increasingly contentious. Subjects of debate included the exchange-rate regime itself, the use of the exchange rate in stabilization programmes and consistency in the management of semi-flexible systems.

18. Mounting external deficits drove up the net demand for hard currencies. In general, however, economic authorities did not allow the market to set parity rates for fear that the climate of widespread uncertainty in international markets might degenerate into uncontrollable devaluations. Financial stability and domestic solvency were also taken into account in defining the acceptable rate of devaluation, as previous episodes of sustained inflows of external capital and local currency appreciation have left many debtors heavily exposed to exchange-rate risk. Another objective in limiting nominal devaluations was to guard against setbacks in terms of inflation control.

19. In these instances, the monetary authorities drew on their reserves to forestall excessive devaluations and hiked interest rates to ward off capital flight. Even in Mexico, one of the few economies with a floating exchange-rate regime, the authorities intervened energetically when pressures began to mount at the start of the second semester. In some cases, especially in Brazil, this policy had two very serious consequences: extremely high interest rates and a loss of reserves. In order to avoid having to modify its exchange-rate regime, Brazil had to request an international rescue package coordinated by the International Monetary Fund. Even so, several countries have revised their exchange-rate policies to accommodate currency devaluations, either by altering the managed floatation band so that the pressure on their currencies can manifest itself in the flexible rate, or by increasing the rate of preannounced devaluations under crawling peg regimes.

20. The greater control gained over inflation in the region and the increased nominal devaluation rate put an end to the tendency towards appreciation which the average real exchange rate has exhibited for much of the 1990s. In the second semester of 1998, there were even some signs of a small depreciation in the region, although substantial differences across countries continued to be observed in terms of both exchange-rate movements and their underlying causes.

Reforms advance despite troubled economic situation

21. The problematic economic situation existing in 1998 did not seriously affect the structural reform programmes under way in the region. In fact, a record US$ 40 billion in assets were privatized during the year; Brazil led the way, since it accounted for 90 per cent of this figure, with much of that sum being represented by the sale of the national telephone company. A number of the region's smaller economies, including those of Central America, were also very active in this area. The privatization and concession process encompassed a wide range of sectors, including everything from telecommunications to public utilities and postal services. Other areas of reform were the labour market, the civil service and the pension system.

22. Trade reforms also moved ahead, with no loss of momentum being noted even in countries troubled by mounting external deficits. Chile, for example, decided to lower its external tariffs in an effort to reach an across-the-board rate of 6 per cent within the next five years, and the Central American countries, too, proceeded with their calendar for reducing their level of external protection.

23. The four trade groups in the region — the Southern Cone Common Market (MERCOSUR), the Andean

Community, the Caribbean Community and the Central American Common Market — continued to make headway with the implementation of their integration agreements. Special emphasis was placed on finding ways to promote convergence among these groups, with MERCOSUR and the Andean Community taking the lead. The progress made in this respect is still quite limited, however, and the devaluation of the Brazilian currency complicated the situation further at the beginning of 1999. As part of another initiative in this field, negotiations on a broader, hemisphere-wide agreement were begun with a view to the establishment of the Free Trade Area of the Americas by the year 2005.

III. Domestic economic performance

Regional growth slows

24. The strong expansion in the level of activity seen in the Latin American and Caribbean countries during 1997 — one of the highest growth rates in recent decades — slackened quite abruptly in 1998. The average GDP growth rate for 1998 is estimated at about 2.2 per cent, more than a full percentage point lower than the average for the 1990s. Per capita GDP should grow by about 0.5 per cent, putting it 15 per cent above its level at the beginning of the decade. Because of its size, the Brazilian economy's sluggish growth rate strongly influenced the regional average. Even if Brazil is factored out of the calculations, however, the slowdown still appears to be quite sharp, with the rate falling from 6.6 per cent in 1997 to 3.5 per cent in 1998.

25. This slowdown in the overall level of activity was due to the results recorded by 13 of the countries in the region (notably Argentina, Brazil, Guyana, Peru and Venezuela, where growth in 1998 was between 3.5 and 7 points lower than the year before, although Paraguay and Venezuela, in Latin America, and Guyana and Jamaica, in the Caribbean, are the only countries in which an actual contraction was recorded for the year as a whole. Costa Rica was the one country to buck this trend and turn in a substantially better performance than the year before, with a 6 per cent growth rate that was second only to the figure for the Dominican Republic, which posted a 7 per cent rate for the third year in a row. Quite high growth rates (between 4 and 6 per cent) were reported by eight countries and another seven had rates of between 2 and 4 per cent.

26. The downswing in the region's economies was more serious than the above figures suggest because in many countries it deepened as the year drew on. In the early months of 1998, their economies continued to exhibit the strong dynamism they had shown in 1997, but as the impact of the international financial crisis began to make itself felt through a steep drop in capital inflows, which in several countries compounded a severe deterioration in the terms of trade, the expansion of output began to flag, coming to a virtual standstill in the final months of the year. The downturn in the terms of trade also affected national income, which is estimated to have edged up by just slightly more than 1 per cent.

27. Investment was a stimulus for growth in most of the countries, since it outpaced GDP. Thus, when measured as a share of output for the region as a whole, this variable shows a slight increase over its 1997 level. Since public-sector investment funds were cut back in many instances as part of Governments' attempts to control their fiscal deficits, most of the growth in investment came from the private sector, with foreign direct investment flows playing a key role in this respect. Consumption expanded at much the same rate as total output, while export volumes progressed (8 per cent), but at a considerably slower pace than in the past. The volume of imports also grew more slowly than before (10 per cent vs. 26 per cent), but nonetheless continued to outdistance the rate for exports.

28. The unfavourable conditions observed in 1998 were reflected more clearly in the industrial activity of the countries of the region. The most serious downturn was in Brazil, where industrial output is expected to have dropped by 3 per cent after having climbed by over 4 per cent in 1997. The results were also poor in Argentina, where industrial activity slid during the closing months of 1998 following a strong performance early in the year. The same thing happened in Chile, Colombia and Venezuela, all of which exhibited clearly recessionary trends in the final quarter. Mexico's industrial growth rate also slumped towards the end of the year, but the rate for the first nine months of 1998 was much higher (nearly 8 per cent). Nevertheless, the downward trend was expected to deepen from the fourth quarter of 1998 on. The situation was quite different in Peru, where activity waned in the first two quarters as a consequence of El Niño, which had a particularly serious impact on the production activity of industries that process agricultural and fishery products. Activity then rebounded during the second half of the year once the adverse weather conditions caused by this phenomenon came to an end.

29. Economic activity in a number of countries was adversely affected in 1998 by El Niño, which caused serious droughts and flooding that had a particularly severe impact on agriculture. Housing, social infrastructure and production facilities were destroyed or damaged by extensive flooding

along the coasts of Peru and Ecuador and in various areas of Argentina, Chile, Brazil and Paraguay. Fisheries were also hurt by this phenomenon. In the closing months of 1998, Central America and the Caribbean were hit by two hurricanes that caused an enormous amount of destruction. Honduras and Nicaragua were hit particularly hard in late October by Hurricane Mitch, which also damaged Guatemala and El Salvador. Preliminary estimates put the direct and indirect losses at over US$ 7 billion.

Outlook for 1999 is problematic

30. The economic growth of Latin America is expected to weaken further in 1999 as a result of the continuing international economic crisis and the impact of the adjustment policies that countries have begun to implement in order to cope with it. The region's export prices will remain low for at least several more months, which will hurt its balance of payments and fiscal accounts. This will make it necessary to proceed with macroeconomic adjustment measures that will lead to a contraction of economic activity. In some of the Central American and Caribbean countries, these factors will be compounded by the effects of the storms and other adverse weather conditions that affected them during the second half of 1998. These phenomena seriously impaired vital economic activities, and the after-effects are expected to persist for quite some time.

31. The region's overall growth rate is expected to be slightly negative, with a rate of over 5 per cent being registered by only one country and actual decreases in the level of activity in four of the 19 economies considered. The crisis in Brazil will severely affect its main trading partners in MERCOSUR, particularly Argentina.

Inflation stabilizes at its low 1997 level

32. After the steep reduction in inflation seen between 1990 and 1997, the regional rate fell only marginally in 1998. In recent years, a dramatic drop had been observed, with inflation plummeting from 882 per cent in 1993 to 335 per cent in 1994, 26 per cent in 1995, 18 per cent in 1996 and 10.3 per cent in 1997. For 1998, the rate for the 12 months to December is estimated at 10.2 per cent, the lowest in nearly 50 years. The significance of the average rate is reinforced by the fact that 13 of the 22 countries considered had single-digit inflation rates. Moreover, in the majority of countries the rate fell or remained low; only Ecuador, Nicaragua and Paraguay had significant increases. Although Venezuela reduced its rate from 38 per cent to 30 per cent, this was still high in comparison with the region's current patterns and was exceeded only by Ecuador, where prices rose by 43 per cent.

33. Argentina continued to maintain its record as best performer, registering near zero inflation, as it had also done during the two previous years. Brazil consolidated its control over price increases as, after experiencing four-digit inflation in the late 1980s and early 1990s, its inflation rate in 1998 was only 2.5 per cent. The biggest advances occurred in the Dominican Republic, Haiti and Uruguay; in the case of Uruguay, the inflation rate may well turn out to have been the lowest since 1957. Currency devaluations were the primary cause of inflation in a number of countries (Ecuador, Nicaragua and Paraguay).

34. The significant deceleration of inflation in the 1990s has mainly been due to a change in economic policy in recent years. The fight against inflation has come to be the highest priority of macroeconomic policy, and this policy effort worked in conjunction with structural reforms and a promising international environment until mid-1997. The financial problems affecting the world economy in 1998 did not have strong repercussions on domestic prices. With the exceptions mentioned above, devaluations did not translate into significant price rises either, given the restrictive monetary policies and recessionary situation that existed in various countries of the region.

Labour markets suffer a reverse

35. The slower rate of economic growth in 1998 translated into higher unemployment, which rose from 7.3 per cent on average for the region in 1997 to 7.9 per cent in 1998. This increase was primarily due to a worsening situation in the labour market in Brazil and Colombia, where unemployment climbed significantly. In contrast, thanks to a relatively rapid pace of growth — even if slower than the year before — the annual average rate of unemployment in most of the countries in the region was stationary or even fell. Sizeable reductions in joblessness were reported in Argentina, Barbados, the Dominican Republic, Mexico, Nicaragua, Trinidad and Tobago, and Uruguay. It is important to note, however, that all of these countries except Mexico still have double-digit unemployment rates.

36. In the second half of the year, the deceleration of growth in many countries began to be reflected in the labour market. Accordingly, the unweighted average rate of employment for the countries having this information available — which had risen sharply in the second half of 1997 and moderately in the first half of 1998 — showed a small decline. The weighted average employment rate exhibited a different trend, with a large decrease in the first

part of the year and a small upswing in the second; this was mainly due to the influence of Brazil, where this latter pattern predominated.

37. Overall, the employment rate was down. Specifically, the demand for labour weakened in various formal sectors of activity that were hurt by the problems existing in the external sector and by adjustment measures; this is what occurred, for example, in Chile's mining, forestry, fishery and construction industries. In some of the countries ravaged by natural disasters, jobs were lost in agriculture, as in the case of Honduras' banana plantations. Most countries saw a reduction in employment in manufacturing as a consequence of the more sluggish growth of domestic demand, external competition and labour-saving restructuring plans. As a result, in many cases job creation was concentrated in informal sectors of the economy in 1998. In some countries, however, such as Mexico, the buoyancy of the economy also led to the creation of a significant number of jobs in formal sectors of activity.

38. In the context of a slacker demand for labour, real wages in the formal sector stagnated or fell slightly in most countries. In fact, of the countries having information available, only Chile and Uruguay registered increases of more than 1 per cent.

IV. External sector

Current account deficit continues to widen

39. The combined effects of an international financial crisis and a series of weather disasters were reflected in the deteriorating position of the external sector in the majority of the countries. Thus, the trend towards widening current account deficits intensified. The aggregate regional deficit rose from 2 per cent of GDP in 1996 to over 3 per cent in 1997 and topped 4 per cent in 1998, although the latter percentage was pushed up by the devaluation of many of the countries' currencies, which lowered the value of GDP measured in dollars. The current account deficits were close to the regional average in the three largest economies (Argentina, Brazil and Mexico) but reached levels around or above 7 per cent of GDP in Chile and the Andean countries other than Venezuela.

40. The increased current account deficit for Latin America and the Caribbean in 1998 was due to the marked deterioration in the trade balance since factor services did not change much. Although profit remittances continued to expand, interest payments increased very little. In contrast to 1997, in 1998 the region had to resort to international reserves and compensatory capital in totalling nearly US$ 21 billion to finance the current account deficit. The decline in reserves was particularly marked in Brazil, Chile and Venezuela, and somewhat less so in Colombia and Peru. On the other hand, some countries did increase reserves, notably Argentina and Mexico.

41. Although the trend towards deteriorating current accounts and trade balances continued, the reasons for it were radically different from what they had been in previous years. Whereas in recent years the import-export gap was due to a surge in imports, in 1998 it was due chiefly to a weakening trend in the value of exports.

Exports slacken

42. The value of regional merchandise exports declined, albeit marginally, for the first time in 12 years. This change, as compared to the previous year, was due to a sharp drop in prices, which was not totally offset by the slower growth in export volumes.

43. The unit value of the region's exports declined on average by more than 8 per cent. This reflected the sharp drop in commodity prices in world markets, which were heavily influenced by the financial crisis that erupted in Asia during the second half of 1997. Prices of raw materials, both from mining and agriculture, were particularly affected. The average price index elaborated by ECLAC shows a decline with respect to the previous year of 15 per cent in the prices of minerals and tropical beverages and more than 10 per cent in the prices of food and agricultural raw materials. Moreover, during the first quarter of 1999, the prices of many products continued to drop.

44. The price of oil was halved between October 1997 and December 1998, falling to its lowest level in 12 years. That one fact explains why Venezuela experienced by far the greatest decline (25 per cent) in export unit value. Ecuador, Chile and Peru suffered declines of between 13 and 14 per cent. The latter two countries were hard hit by the falling prices of metals, particularly copper. In Colombia and Paraguay, the losses were about 10 per cent, while some other countries experienced smaller but still substantial declines. In the Central American countries, export unit values either declined slightly or held stable; banana prices were firm, and there was a lag before the drop in the price of coffee was reflected in sale contracts. The Caribbean countries were variously affected: Trinidad and Tobago suffered losses in terms of its exports of hydrocarbons and petrochemical products that amounted to the equivalent of 2 per cent of GDP, while Guyana and Jamaica were hurt by lower prices for bauxite.

45. The majority of the countries were able to make up for the drop in prices to some extent by expanding export volumes, but growth in that respect was less dynamic than in previous years because of the problems importing countries were experiencing. Reduced demand was most evident in the Asian economies, and this seriously dampened export sales for Chile and Peru in particular. Also a factor was the economic slowdown in some other countries, such as Brazil, an important market for many Latin American exporters. The good performance of the United States economy, by contrast, benefited Mexico in particular as a member of the North American Free Trade Agreement (NAFTA).

46. On the other hand, preliminary figures suggest that exports of manufactures were the best performers in some countries of the region, and helped to soften the impact of the declines in primary commodities, which make up the bulk of the region's exports. These differing trends are consistent with indications that exports to other markets within the region again grew more rapidly than exports to the rest of the world. The data so far available suggest a clear tendency in that direction within the Andean Community and the Central American Common Market, but the trend was halted in the case of MERCOSUR by the impact of the cooling of the Brazilian economy on the exports of its neighbours.

Imports slow and terms of trade worsen

47. Imports slowed throughout the region as domestic demand weakened and the currencies of many of the countries, for the first time in several years, underwent real depreciation. The most drastic adjustment occurred in Brazil, nearly the only country where import volume actually contracted. There, as in the other large economies, the flow of imports remained heavy during the early months of the year but gradually slackened as the domestic economic situation deteriorated. Growth in import volume for the region as a whole was 11 per cent, considerably less than half the figure for the year before, but similar to that for 1996.

48. In value terms, the reduction was even greater, as prices of imported products fell significantly throughout the region. One factor was the worldwide decline in prices of manufactures, reflecting lower prices for raw materials and more intense competition due to the devaluation of Asian currencies; at the same time, petroleum and other raw materials imported by the countries of the region became cheaper. As a result, the region's bill for imports of goods increased by only about 5 per cent, after two years of strong expansion. Currency savings were especially significant in purchases of oil and gas; most of the petroleum-importing countries for which information is available paid from 20 to 40 per cent less than the previous year for oil and gas.

49. The slackening pace of imports was due in part to greater difficulty in financing them, owing to constraints on external borrowing and slower growth of the purchasing power of exports. The latter expanded by only a little over 3 per cent for the region as a whole, owing to a combination of weak growth in export volumes and the deterioration in the terms of trade.

50. The decline in the region's terms of trade, however, was limited to 4 per cent, thanks to the considerably cheaper prices for imports. While roughly half the countries suffered a deterioration in their terms of trade, the other half found that lower prices for their exports were more than offset by lower prices for the products they imported. The chief gainers in this respect were the Central American countries, Uruguay and the Dominican Republic, where the effect of the improvement in the terms of trade was equivalent to about 1 per cent of GDP or more; in the case of Honduras the figure was 3 per cent, in Nicaragua 4 per cent. The chief losers were the exporters of petroleum (Ecuador, Trinidad and Tobago, and above all Venezuela) and metals (Chile, Jamaica, Guyana). Terms-of-trade losses exceeded 5 per cent of GDP in Venezuela and 2 per cent in Chile and Ecuador. In Brazil, the two effects offset one another.

51. The net aggregate effect of the variation in the terms of trade for the region as a whole was negative and amounted to over US$ 10 billion, equal to nearly half of the international reserves lost by the region in 1998 and to 0.5 per cent of the region's GDP for the year.

Capital inflows moderate

52. The impact of the international financial crisis on capital flows to Latin America, already observable in some countries of the region in the fourth quarter of 1997, was felt more broadly in 1998, especially from August onward, as the region began to experience the effects of the devaluation of the rouble and the Russian Federation's unilateral debt moratorium. In 1998, Latin America received only US$ 62 billion in capital inflows, compared with an influx of US$ 80 billion in 1997 (as a percentage of GDP, a decline from 4.2 to 3.2 per cent). Autonomous capital inflows declined in over half of the Latin American and Caribbean countries. Among those most heavily affected were Brazil, Chile and Peru; Venezuela continued to record a net outflow. Five others, notably Argentina, managed to increase their external financing.

53. A significant feature of external financing in 1998 was that a large proportion continued to take the form of medium-term and long-term funds, especially foreign direct investment. In several countries, lending from multilateral organizations assumed greater importance, including some important loan commitments for disbursement in 1999. On the other hand, there were outflows of short-term capital and sharp declines in stock market investment in most of the countries of the region. The latter occurred chiefly between August and October 1998, when substantial short-term capital flight occurred, especially from Brazil.

54. Net foreign direct investment inflows to the region remained close to the extraordinary level of US$ 57 billion achieved in 1997. In nine Latin American countries, foreign direct investment again financed over half of the current account deficit on the balance of payments. The chief beneficiary was Brazil, which received a record US$ 22.5 billion. Much of that amount came from the privatization of the telecommunications system, the largest such sale in the history of Latin America. Although flows to Argentina, Chile, Colombia and Mexico slowed, they nonetheless contributed significantly to financing the current account deficit. Also important were the direct investment flows to some Central American and Caribbean countries, notably El Salvador and Guatemala.

55. Bond issues in the first half of 1998 amounted to US$ 28 billion in gross terms, a figure similar to that recorded in the first half of 1997. Argentina, Brazil, Mexico and Venezuela continued to account for most issues. The cost of external financing did not increase significantly during the first half of the year. Towards the end of August, however, the cost of financing in the secondary market rose considerably, to nearly 15 per cent per annum, and then only partially reversed course during the closing months of the year. Because of the higher cost, Governments and companies in the region placed no new bond issues between August and October 1998. It was not until November that the Government of Argentina tested the waters with a bond issue for US$ 1 billion, the first major issue to come out of the region since the international crisis intensified in August; it was followed by an issue for US$ 1.5 million by Pemex of Mexico. As a result of this adverse effect during the second semester, the total value of issues during the year (US$ 38 billion) was 30 per cent lower than in 1997. This trend continued during the first quarter of 1999, with the notable exception of Mexico.

56. Bank credit to the region rose by only 5 per cent in the first half of 1998, and loans were concentrated entirely in the first quarter. Since the eruption of the Asian crisis in October 1997, at times syndicated loans have been the only external credit option open to some Latin American countries. Moreover, they have offered better credit terms than bonds. However, syndicated financing has been very selective, available only to a few Governments and companies in the region. Supplier credit, on the other hand, which makes up the greater portion of short-term debt in most of the economies, has continued to be granted as usual.

57. The international financial crisis depressed stock market prices; between October 1997 and mid-September 1998, the region's stock exchanges all registered declines. During that period, the regional index fell by a cumulative 50 per cent after several years of gains. Although in mid-September the regional index of stock prices began to recover, by December 1998 it still had not risen above the level reached at the beginning of 1996. Thus, foreign investment in stock market assets was one of the flow components most heavily affected during 1998. By September 1998, it had dropped off by US$ 10 billion in the countries of the region for which information is available. One of the elements of stock market investment, issues of American Depositary Receipts, which had reached US$ 5 billion in 1997, was negligible in 1998 (US$164 million).

The pace of growth of the external debt quickens

58. In 1998, the region's external debt expanded to some US$ 700 billion, increasing by 7 per cent in nominal terms, a pace faster than the previous year's and similar to the growth rate in 1995. The expansion was not evenly distributed, however, and was attributable largely to the increased external debt of a few countries, chiefly Argentina, Brazil and Chile. In Chile, the increase was due to greater private-sector borrowing, whereas in Argentina the expansion of the public sector's external debt was the key factor. Other countries did not increase their external debt significantly, and some may have actually reduced it in nominal terms.

59. For the first time in the 1990s, the indicators of the region's external debt burden reflected a change for the worse, chiefly because of the stagnation in exports of goods and services. For example, the ratio of accrued interest to exports of goods and services rose from 14.3 to 15.2 per cent, and the ratio of the external debt to exports of goods and services rose from 194 to 209 per cent. Although the deterioration was widespread, debt indicators for half of the countries were still considered acceptable. For the other countries, especially some of the Central American countries, indicators continued to provide grounds for concern.

60. With regard to external debt renegotiation, in 1998 a debt relief programme went into effect in Bolivia under the terms of the Heavily Indebted Poor Countries Debt Initiative. Also under that initiative, the International Monetary Fund, the Inter-American Development Bank and the World Bank announced that they were considering the possibility of an external debt relief programme for Nicaragua and Honduras.

Latin America and the Caribbean: total gross domestic product

(Percentages based on values at 1995 prices)

	Annual growth rates								*Average annual rate*			
	1991	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998[a]*	*1981*	*1990[b]*	*1991*	*1998*
Latin America and the Caribbean[c]	**3.8**	**3.2**	**3.8**	**5.8**	**1.0**	**3.6**	**5.5**	**2.2**		**1.0**		**3.6**
Latin America and the Caribbean (excluding Brazil)	**5.7**	**5.4**	**3.4**	**5.5**	**-1.0**	**4.1**	**6.6**	**3.5**		...		**4.1**
Subtotal (19 countries)[c]	**3.8**	**3.2**	**3.9**	**5.8**	**1.0**	**3.6**	**5.5**	**2.2**		**1.0**		**3.6**
Subtotal (19 countries excluding Brazil)	**5.8**	**5.5**	**3.5**	**5.5**	**-1.1**	**4.1**	**6.6**	**3.5**		...		**4.2**
Argentina	10.0	8.9	5.8	8.3	-3.1	4.4	8.0	4.2		-0.7		5.7
Bolivia	5.4	1.7	4.2	4.8	4.7	4.4	4.2	4.7		0.2		4.3
Brazil	1.0	-0.3	4.5	6.2	4.2	2.9	3.8	0.2		1.3		2.8
Chile	7.3	11.0	6.6	5.1	9.1	6.8	6.4	3.3		3.0		6.9
Colombia	1.6	3.9	4.5	6.3	5.4	2.0	3.2	0.2		3.7		3.4
Costa Rica	2.2	7.1	5.8	4.3	2.2	-0.5	3.4	6.2		2.2		3.8
Cuba[d]	–	–	–	0.6	2.4	7.8	2.5	1.5		3.7		-3.1
Ecuador	5.0	3.0	2.2	4.4	3.0	2.3	3.9	0.8		1.7		3.1
El Salvador	2.8	7.3	6.4	6.0	6.2	1.9	4.0	3.4		-0.4		4.7
Guatemala	3.7	4.9	4.0	4.1	5.0	3.0	4.3	4.7		0.9		4.2
Haiti	0.1	–	-2.2	-8.3	5.0	2.8	1.3	2.9		-0.5		-1.7
Honduras	2.7	5.8	7.1	-1.9	3.7	3.8	5.1	3.0		2.4		3.6
Mexico	4.2	3.7	1.7	4.6	-6.2	5.5	7.1	4.8		1.8		3.1
Nicaragua	-0.3	0.8	-0.4	4.0	4.5	4.8	5.5	4.0		-1.5		2.8
Panama	9.0	8.2	5.3	3.1	1.9	2.7	4.9	3.9		1.4		4.8
Paraguay	2.5	1.7	4.0	3.0	4.5	1.1	2.4	-1.0		3.0		2.3
Peru	2.9	-0.6	6.0	14.7	8.8	2.2	8.2	0.7		-1.2		5.3
Dominican Republic	0.8	6.4	2.0	4.3	4.5	6.8	7.1	7.3		2.4		4.9
Uruguay	2.9	7.4	3.1	5.5	-2.0	5.0	5.0	4.0		0.0		3.8
Venezuela	10.6	7.1	-0.5	-3.8	5.5	-0.9	5.5	-0.7		-0.7		2.7
Subtotal Caribbean[c]	**1.7**	**1.0**	**0.4**	**3.4**	**2.4**	**3.0**	**1.9**	**1.2**		**0.1**		**1.7**
Antigua and Barbuda	4.1	1.0	3.5	4.8	-4.3	5.5	4.6	...		6.1		2.7[e]
Barbados	-3.5	-5.4	1.0	3.6	2.5	5.1	3.0	2.0		1.1		1.0
Belize	3.2	8.9	4.0	1.6	3.5	1.1	4.4	1.4		4.5		3.5
Dominica	2.6	3.0	2.2	2.1	2.3	2.9	2.4	2.4		4.4		2.5
Grenada	3.7	1.0	-1.1	3.4	3.0	3.2	4.7	5.9		4.9		3.0
Guyana	10.2	11.2	3.1	17.7	2.4	9.2	6.1	-1.6		-2.9		7.1
Jamaica	0.3	2.5	1.8	1.9	1.7	-0.5	-2.3	-3.5		2.2		0.2
Saint Kitts and Nevis	3.4	3.6	6.7	3.3	3.1	5.5	...	...		5.8		4.3[e]

	Annual growth rates								Average annual rate			
	1991	1992	1993	1994	1995	1996	1997	1998[a]	1981	1990[b]	1991	1998
Saint Vincent and the Grenadines	0.1	8.9	-0.3	-3.3	8.3	1.4	2.2	..		6.5		2.4[c]
Saint Lucia	-2.0	7.3	0.4	1.9	0.7	0.5	0.9	1.9		6.8		1.4
Suriname	3.5	-1.7	–	-2.3	-4.7	8.7	5.0	...		0.5		-0.4[c]
Trinidad and Tobago	3.5	-1.1	-1.2	4.2	4.1	4.5	4.0	5.0		-2.6		2.8

Source Economic Commission for Latin America and the Caribbean, on the basis of official figures converted into dollars at constant 1995 prices.

Note Totals and subtotals do not include those countries for which no information is given.

[a] Preliminary estimates.

[b] Calculated on the basis of figures at constant 1990 prices.

[c] Excluding Cuba.

[d] Calculated on the basis of constant prices in local currency.

[e] Based on figures at factor cost.

[f] 1991–1997.

[g] 1991–1996.